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Financial Markets

Irving Trust

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Economic Research & Planning Division

Friday (Noon) Feb. 20, 1981

This week financial markets suddenly stopped ignoring the Federal Reserve (in favor of concentrating on the various business activity statistics) and began to perceive that the pattern of softness in the Federal funds rate was no aberration. Instead, as reported here last week, it evidenced a shift toward ease in the policy stance of the Federal Reserve. The rally that followed the market's perception of this fact was dramatic. Rates on 90-day Treasury bills were pared back over 100 basis points, while the Treasury's long bond soared about 5 points in price.

Where do we go from here? The high interest rates of the past several months are clearly beginning to "bite" and are trimming the growth of the monetary aggregates. For example, despite the influx of NOW accounts, M-1B growth has been essentially flat since November. That pattern clearly reduces the pressure on the Fed to constrain reserve availability to the banking system. Nevertheless, one should keep in mind that the minutes of the December 18 FOMC meeting revealed that the Committee was very concerned about letting interest rates fall too far, too fast. With that in mind, it would not be surprising to see overt resistance from the Fed in the next few weeks if the funds rate should drop as low as 13% or 14%. Another problem is the impending heavy supply of Treasury debt offerings as well as the huge pent-up supply of corporate bond issues. Clearly, the long-term sector will have especially great difficulty in participating in the continued rally.

For technical reasons the Fed should be entering the market several times in the next few weeks to drain reserves temporarily. Though some participants will probably interpret these actions as running counter to the recent easing of the Fed's policy stance, in practice they need not produce any increases in the funds rate. In fact, to the extent that the operations were delayed, funds might be expected to be soft.

Finally, the descent of the funds rate below the 16% level naturally raises the question of whether--and when--the Federal Reserve discount rate or the 3% supplementary charge to large, frequent borrowers will be reduced. In view of the Fed's reluctance to encourage a pell-mell drop of interest rates like that of last spring, the betting is good that the supplement will be cut or dropped entirely well before the 13% basic rate itself is changed. As for the timing of the change of the supplement, the next week or two appears to be a good possibility.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	2/20/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	19.50%	19.50%	16.25%
Effective since	2/3/81		
Discount Rate at Federal Reserve Bank	13.00	13.00	13.00
Federal Funds	14.50	16.50	15.00
Repurchase Agreements	14.00	16.00	13.75
U.S. Treasury Issues			
Bills			
3 months	14.83	16.35	14.18
6 months	14.70	16.22	14.65
1 year	14.20	15.12	15.18
Coupons			
2 years	13.63	14.53	14.62
4 years	13.27	14.08	14.10
7 years	13.00	13.64	13.30
10 years	12.94	13.58	13.25
Long Bond	12.57	13.19	12.85
Negotiable Certificates of Deposit-Secondary Market			
1 month	15.15	17.20	15.05
3 months	15.15	17.25	15.10
6 months	15.40	17.10	15.35
1 year	15.15	16.40	15.75
Banker's Acceptances			
1 month	15.85	16.85	14.90
3 months	15.60	16.60	15.50
6 months	14.45	15.90	16.05
Eurodollar Deposits			
1 month	15.94	17.88	16.25
2 months	16.25	18.06	16.38
3 months	16.38	18.13	16.63
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.00	16.00	13.25
1 month	14.25	16.25	14.00
3 months	14.00	15.50	13.00
Bank Holding Companies			
1 month	15.00	16.50	14.25
Dealer Placed:			
3 months	14.63	15.50	14.30
New AA Corporate Utility Bond	15.00	15.50	14.40
Tax Exempt			
6 month Project Notes	6.80	7.60	7.10
1 year AAA Bond	7.00	7.10	NA
5 year AAA Bond	7.65	7.75	NA
20 year AAA Bond	9.40	9.00	7.95

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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